RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Oct. 25, 1995 **LETTER 1185**

OPENING COMMENT: This clip is from the front page of the Oct. 16 *WSJ.*

> GOP TAX WRITERS moved closer to an expected showdown with President Clinton after Senate Finance Committee members reached agreement on a $245 billion, seven-year package of breaks for families, investors with capital gains and businesses. GOP analysts say the plan will add an estimated $93 billion to the national debt even as Republicans seek to balance the budget by 2002.

Over the last 12 months exactly $384 billion has been *added* to the national debt. Question: Are the Republicans nuts or what? Comment: The stubborn Senate is blocking a good deal of the House's so-called "Republican revolution." In March the Senate killed the balanced budget amendment. As of now, the Senate is blocking welfare reform, tax cuts, term limits, tort reform and legal services. Zzzzz.

THE PICTURE: A lot of people are expending a lot of time and energy trying to pick the exact day or week or month when this market tops out and a primary bear market starts.

A lot of other people are telling themselves and anyone who will listen that "times have changed," that "this time it's different," that "bear markets are a thing of the past," or if, indeed, something akin to a "bear market" does arrive, it will take the form of a very mild 10% or 15% correction.

My stance at this time is simply to watch and wait. The Dow Theory tells us that "the trend continues in force until proven otherwise," which is a theorem that has withstood the test of time. So far, I don't discern an "otherwise." So to put it succinctly, the trend remains up.

The high for the D-J Industrial Average was recorded back on September 14 at **4801.80.** The Transports recorded their own bull market high two trading days later (Sept. 18) at **2000.39.** Then on Oct. 19 the Dow shot to a new high of **4802.25.** The new Dow high was widely **unconfirmed** (see Late Notes, page 6).

Below are some of the items I am now following closely:

(1) With the Dow at an unconfirmed new high, what can we expect next? Or to put it another way, which one is right, the new-high Industrials or the lagging Transports?

(2) I keep an A-D line of the 30 Dow stocks (i.e., a plurality of the 30 stocks advancing or declining). The Dow A-D line has been lagging badly, meaning that *too few* Dow stocks have joined the Dow rally, a negative sign.

(3) Daily new highs, are they coming through on the rallies? So far, new highs are *not impressive,* and this is an area worth watching. Also, new daily lows are now increasing.

(4) For many months rising bonds (i.e., declining interest rates) have constituted a bullish force on the market. Will rising bonds continue to bull the market, or do rising bonds simply tell us that the economy is about to contract?

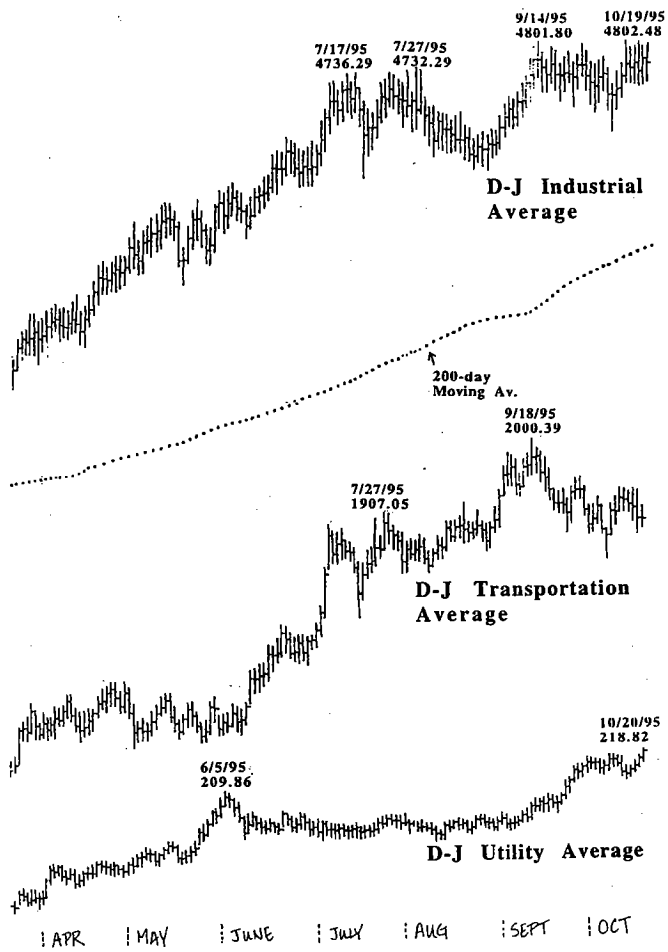
Oct. 13 DJIA 4793.78; PTI 4298; A-D Ratio -3.36
Oct. 20 DJIA 4794.86; PTI 4300; A-D Ratio -3.56
Dow Yield: 2.42%; Dow Price/Earnings: 15.0
Dow 200-day MA: 4386; Dow 30-day MA: 4768
Dow Times Book Value: 3.67; PTI 89-day MA: 4236
Percentage of Undervalued Blue-chips: 4%
Gold 200-day MA: 385.12; Gold-PTI: 609

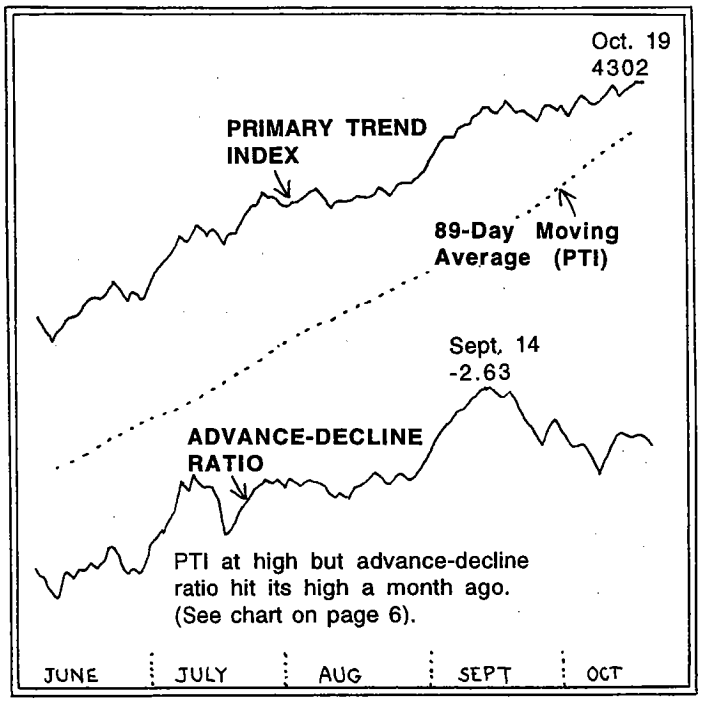
(5) Very important -- is my Primary Trend Index (PTI) moving up in step with the market or preferably LEADING the market? So far, the PTI has been leading on the upside, obviously a plus.

(6) How is the market reacting to news; does bad news knock it down, does good news boost it? So far, I'd say that the market has been reacting bullishly to good news while ignoring bad news. A plus on both counts.

Following are some thoughts that continue to haunt me: (a) We haven't had a single decline of 3.3% in the Dow so far this year. We've never in this century gone from January to mid-October without *at least* a 3.3% correction.

(b) This year, 1995, is the fifth consecutive year in which the Dow has not experienced so much as a 10% decline. In all stock market history, there has never been a string like this. In fact, there has never been three consecutive years without a decline of over 10%. Russell guess: when the decline does come, it will more than make up for this "aberration."





This unprecedented string of five consecutive years without so much as a 10% decline has undoubtedly been a major reason for the extraordinary confidence seen by mutual fund buyers.

Actually, talking about non-corrections, since 1974 there has not been a single year in which the Dow closed below the low of a preceding year. To us old-timers, that isn't heartening, it's downright frightening.

Ned Davis Research just published the figures below. As you can see, the current stretch (since 10/11/90) is by far the *longest* period in stock market history without at least a 12% correction. By the way, following the "high date" shown on the chart, in each case a major decline or bear market materialized, either immediately or within a few months. The single exception in time lag was 11/28/28; ten months after that date the stock market embarked on the worst bear market in history. This is an ominous series that should be studied carefully. **Rationale:** an extended period of time without a correction implies extreme optimism. Periods of extreme optimism imply that the market may have discounted the BEST that can be seen ahead. When the market has discounted the best that lies ahead, there's nowhere to go but down.

LONGEST DJIA ADVANCES WITHOUT A 12% CORRECTION

Date of Low	Date of High	% Gain	Days
11/15/07	11/19/09	89.7	735
10/19/26	11/28/28	103.0	771
07/26/34	03/10/37	127.3	958
04/28/42	05/29/46	128.7	1492
07/13/50	01/05/53	48.8	907
09/14/53	04/06/56	103.9	935
10/22/57	01/05/60	63.3	805
06/26/62	02/09/66	85.8	1324
07/24/84	08/25/87	150.6	1127
12/04/87	07/16/90	69.8	955
10/11/90	???	100.4*	1819

Advances based on rise of at least 12% following decline of at least 12%.
**As of 10/4/95.*

Question: The stock market now seems to be churning or stalling around the highs (held up mainly by declining interest rates). Is there a possibility that a bear market could be starting?

Answer: The stock market is overvalued, it's uncorrected, and it's very old in the tooth. So anything is possible. But in this business you learn to deal with the reality. And the reality is that there has been no breakdown in the bullish action yet, at least from a Dow Theory standpoint.

An old Chinese proverb tells us that before you can walk a mile, you have to take a first step. From a bear market standpoint, *I don't consider that the market has yet taken the first step down.* I stated in the last Letter that a first bearish step would entail the D-J Industrials breaking below **4700** accompanied by a Transport violation of **1900.** The Transports did break below 1900 on one single day (Oct. 10), but the Industrials did NOT confirm. Immediately after the Transport break, the market moved higher.

Question: Russell, I note that there has been, and still is, a good deal of caution around. A lot of analysts and even some newspaper columnists have been warning that the market is high and that a correction can be expected. This is hardly the background atmosphere for a bear market. What do you think?

Answer: Obviously, there are pockets of worry and even extreme bearishness in certain quarters. But let's be clear about this -- it is widely *conceded* that stock yields are extremely thin, that the market has not experienced a correction in years, and that mutual fund buying has reached the mania stage. Nothing's going to change those perceptions. Thus, I don't care how high this market climbs, the caution in certain quarters is going to *remain.* And those observations about market overvaluation aren't perceptions, they are FACTS. Consequently, I don't consider these pockets of pessimism to be a bullish factor.

Actually, there is one area that I consider very worrisome. It's the area of mutual funds. Frankly, I'm far more interested in what the masses of people are DOING, rather than what certain bearish groups are saying. And what the public has been doing is buying its head off in mutual funds. Thus (and I've said this repeatedly), stocks have moved into weak (public) hands -- and to a greater extent than I've ever seen before.

Question: Russell, if we were to head into a primary bear market, wouldn't you look for a sudden, "unexpected" stock market crash?

Answer: Not necessarily. Each bull market and each bear market has its own character and its own way of developing. Remember, we have the examples of the 1987 crash and even the mini-crash of 1990 fresh in our minds. Each of those crashes were followed by new highs in the Dow and in many stocks. I think most people today associate crashes with scary but rapid wipe-outs but also with great buy areas.

Even if a bear market were to start, I wouldn't necessarily expect an early crash. Remember, the bear's most fervent wish is to decline while taking as many stockholders as possible with him. In other words, the bear doesn't want to tip his hand; he wants the great mass of stockholders to remain (happy and hoping) on the down-elevator.

My feeling has been that if or when a bear market starts, it's going to be a case of *erosion* rather than a tell-tale, frightening crash. The stock market advanced for many years in an orderly fashion; it advanced relentlessly, but all the while volatility held extremely low (actually we saw record low volatility).

Therefore, I would expect a bear market to work its way down in much the same way, although we must remember that the price action in bear markets always develops faster than in bull markets. From the sentiment standpoint, remember this-- *a bull market climbs a wall of worry; a bear market descends on a cushion of HOPE.*

Along these lines, it's interesting to note that probably 75% of today's advisors have never lived through a primary bear market such as 1973-74. They have never seen month after month of

declining prices; they have never experienced markets that have become oversold and then remained oversold for months on end. They have never seen oversold indicators that cease to work as they are "supposed to." They have never seen stocks lose 50% to 75% of their value and then continue down.

Question: What "mysterious force" has impelled the public to take their hard-earned money *en masse* out of their 401(k)s and savings accounts or salaries and then systematically place that money with any number of mutual funds? Below is a section from the October cover of *Harper's* magazine, and this may well answer that question. At any rate, I thought Harper's had an interesting (and probably valid) way of putting it.

If you watch CNBC or Channel 22 out of LA or if you listen to any of the dozens of radio programs dealing with the stock market, you know that most of the talk is about fundamentals -- earnings or the unemployment rate or the trade balance or the money supply (no, cancel the last, because nobody looks at the various, confusing, money supply figures any more).

The point is that most of the talk is about current events, stock earnings, predictions about the future, and other "authoritative" topics.

The problem is that very few people (amateurs or professionals) think of the market in terms of the *great primary trend.* So I keep harping on this very basic point -- **the primary trend rules the market.** As long as the primary trend of the market is bullish, then the Averages will continue to record new bull market highs.

THE SCHOOL OF HARD KNOCKS

HARP

I'm a well-paid, educated, white man. Presumably I shouldn't worry about dying penniless. But I do. I distrust employers and fear that Social Security and Medicare will go broke. I don't expect to be rich, but to retire thirty years from now without public assistance, I'll need $1 million or more. The only way I can imagine accumulating such a sum is to put my future into play—to bet on the stock market.

—*Ted C. Fishman, "The Market in Fear," page 55*

Obviously, the Industrials and Transports will not rise in perfect lock-step, but in general during a bull market the two Averages will advance to successive new highs (even though the new highs are sometimes weeks or even months apart).

Therefore, what I look for is a *change in this pattern.* In other words, if, for example, the Dow rises to new highs and the Transports stubbornly resist, and then two Averages then turn down, this puts us on our guard. If the advance-decline ratio heads persistently down, even while the Dow rises to new highs, this is a danger signal. If my Primary Trend Index traces out a clear downtrend this is another indication that the primary trend of the market may be turning down.

Robert Rhea emphasized that the secondary correction and what the market does *after a secondary correction* is the secret of the primary trend.

As an example, let's say the Industrials and Transports advance to new highs. The two Averages then turn down and decline substantially over a period of a few weeks or longer. Thus, we have what's termed a secondary correction. It is what happens AFTER this secondary correction that contains the secret of the primary trend.

Following the correction, a rally will take place. The rally following the correction will be extremely important. On the rally if one or both Averages fail to advance to new highs -- and they then turn down, the action is critical. For if **both** Averages then violate the preceding secondary lows, at that point we know that a primary bear market will have been signaled.

The Transports turned down from their September high, and I take this as potentially serious. The Transports are the Average which reflects the shipping and sales capabilities of the nation, and thus their decline has me wondering. I would not worry about a minor decline, but as this is written Transports are a full 65 points below their September record high of 2000.39.

In an effort to make trend identification easier, I developed my **Primary Trend Index** (PTI). This is an amalgam of eight different averages and indices. The theory is that as long as at least a MAJORITY of these eight items is rising, then the market force continues to be to the upside. In other words, five out of these eight items have to be rising on a day-to-day basis for a bullish trend to be in place.

But if five or more of these items (i.e., a majority) are declining on a day-to-day basis, then the market equation has swung to the downside and a secondary correction or a bear market is almost surely in force.

So far, as the chart on page 2 reveals, the PTI has remained bullish in that it is above its 89-day moving average. As long as this continues, the power will reside with the bulls.

DOW BREADTH (mentioned at the start of this Letter): So far, the Dow has been the strongest segment of the market. For instance, when on October 10 the Transports broke below 1900 the Dow refused to break below the 4700 level. I've often said, keep your eye on the *strongest segment* of the market. When the strongest segment finally turns weak, the market's in trouble.

I track the breadth of the 30 Dow Industrial stocks daily. In a strong market the Dow breadth keeps up with the Dow. When the Dow breadth lags on a Dow rally, the situation becomes dicey. The Dow A-D line is constructed simply by counting the plurality of Dow stocks each day. For instance, if on a given day 10 Dow stocks are down and 17 are up and three are unchanged, we have a plurality of +7. This is added to the previous day's total. Thus we construct an A-D line based on just the 30 Dow Industrial stocks.

October 17 was a day worth analyzing. On that day the Dow advanced 11.56 points but four more Dow stocks declined than advanced. The whole rise was due to three Dow stocks: Merck, Kodak and IBM.

Note: I don't know how seriously the market takes a potential shut down of the government. This could occur if Clinton vetoes the Republican budget and the Republicans in turn refuse to allow an increase in the debt ceiling. Personally, I take a possible shutdown and its consequences quite seriously.

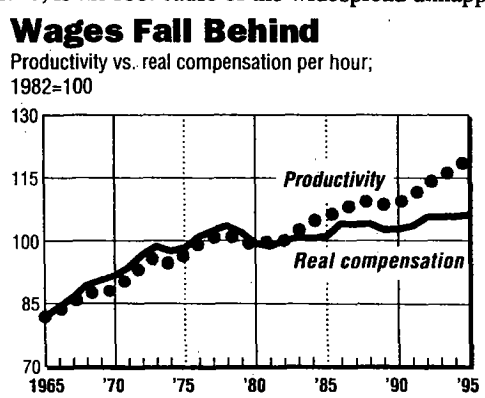
INVESTMENT POSITION: The bull remains in the box. Nothing that has occurred in the price action so far tells us that the bull market is over.

If you're just itching to buy stocks, this list of 14 "top quality buys" from *S&P's "The Outlook"* are well worth studying. All are ranked A or A+ for quality: American Brands, Amer. Int. Group, Chubb Corp., Coca Cola, GE, Leggett & Platt, The Limited, Loral Corp., Medtronics, Merck, Motorola, Pep Boys, Philip Morris, Superior Industries.

I've recommended AIG and Medtronics in previous Letters. I also recommended JP Morgan and Royal Dutch.

But before you buy stocks my suggestion is that you again study the time-spans without a 12% correction listed in the previous section. Remember, these long uncorrected time spans have ALWAYS been followed by major trouble. And the current market is beginning to look tired.

NOTES & QUOTES: If prosperity is here, if the market is at or near its all-time highs, if the restaurants are full and the resorts crowded, why are so many Americans unhappy? Maybe one chart says it all. This chart from the Oct. 12 *WSJ* shows that although productivity has risen steadily since 1980, real (after inflation) wages have been almost flat. The average family, with husband and wife both working, can hardly make it financially (and I'm not even talking about blacks or Hispanics, I'm talking about whites). This, I believe, is the root cause of the widespread unhappiness.



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The Oct. 16 *NY Times* (front page) featured an article which stated that the nation's medical schools are currently bulging with potential new doctors, and new applications are pouring in at RECORD levels. Since HMOs and doctors on salaries are what's happening in medicine today, the nation's older physicians are puzzled. Why would kids want to enter a profession in which practicing doctors are frustrated and angry (many veteran doctors are quitting)? The answer: job security, idealism and the hope of "doing some good in the world."

All of which brings up a Russell prediction, and an important one -- I believe one of the MAJOR problems just ahead for Americans is employment, the problem of finding a job. With corporate lay-offs and restructuring, with the advent of computers, with the farming out of US jobs to low-wage countries, one of the BIG problems facing Americans will be simply landing a job. Actually, the problem is already here -- and remember, this is a bull market and these are the good times! What happens when a bear market arrives? What happens when kids out of college can't find any work? (In Europe it's a big problem already with unemployment in France and Italy at roughly 12%.)

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Clinton: What's he up to now? I think this paragraph from Joe Klein's column in the Oct. 23 *Newsweek* magazine has it right: "The sloppy, hyperactive wonkiness that defined Clinton's first two years in office has been supplanted by a sleek, tactical cunning. He has traded activism for passivism. He gives the appearance of taking stands -- for some sort of tax cut, some sort of welfare reform, some sort of balanced budget -- but these are ploys, mirages; they exist only to undermine positions taken by the Republicans. He doesn't fight *for* anything substantive -- except, of course, re-election. He may have been led down this path by his famously predatory new handler, Dick Morris. More likely, he stumbled upon it himself in a post-election pique: Gingrich wants to change things? Fine. Let *him* see how much fun it is to challenge the status quo . . . Clinton has undercut any serious criticism he might have of the (deeply flawed) Republican budget by joining the witless congressional Democrats in opposition to all meaningful reform. He has done this with a certain bipartisan élan, combining reflexive Democratic freak-the-geezer rhetoric with classic GOP-style tax demagoguery."

And this from advertising great, Jerry Della Femina: "The product has to stand for something. And Clinton stands for everything, therefore he stands for nothing. The Democrats are going the way of Burma Shave and Crisco -- products everyone loved and had in their homes. But they got old. They didn't have anything new to say about the product and after a while they died." About Clinton he adds, "You've tried him, and now you're shrugging your shoulders."

And from columnist Maureen Dowd: *"Democratus Americanus* is vanishing from its natural habitat. It's the incredible shrinking party. Bill Clinton is acting so Republican, he now thinks he's the foreign policy president. Stars like Sam Nunn and Bill Bradley are bailing out. And a raft of other Democrats are retiring, quitting and switching."

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Hollywood is shaken by the failure of so many recent big-budget pictures. Latest to slump are "Jade," "Strange Days," "The Scarlet Letter," "Kiss of Death" and "Assassins." Other bombs are "Judge Dredd," Showgirls," and "Devil in a Blue Dress." What's the problem? Nobody's sure. But the current sky-high cost of some actors isn't helping. It may be that the day of the low-cost producer has arrived. Yet Hollywood keeps hoping that certain high-priced actors have the charisma to "open" any picture. The sad fact that Hollywood's finding out -- it ain't necessarily so.

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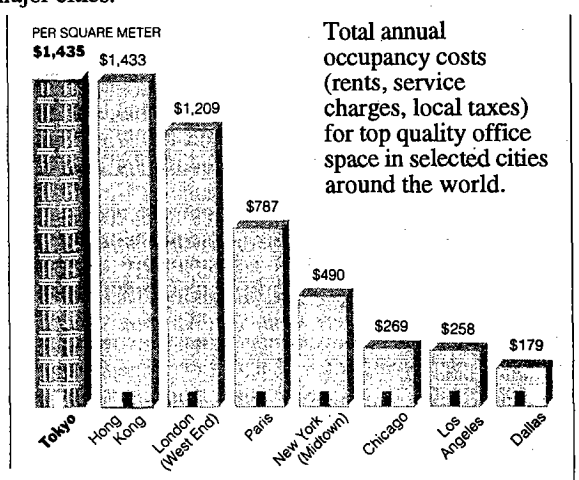
From the *NY Times:* "Real estate values in general have plummeted in Japan by two-thirds to three-fourths from their peak five years ago, making sorry tales of the property slump in most of America almost sweet by comparison. And the collapse is threatening the financial system of the world's second-biggest economy after the US. Fortunes are being lost, companies are going bankrupt, some owners are suffering from diminishing wealth, and the nation's banks, saddled with at least $500 billion in ailing real estate loans, are reluctant to lend a helping hand. Yet Tokyo is still one of the world's most expensive real estate markets. One Japanese government study found some residential land in Tokyo still selling for 30 times as much as land in NYC . . . The story of Japan's boom-to-bust property market is particularly sobering for Japan's nervous Asian neighbors, like Hong Kong, India, Singapore, China, Taiwan and S. Korea, where go-go growth has sent property prices spinning out of control. A Japanese government study shows that the world's seven most expensive cities for commercial land values are in Asia . . . Some analysts fear that Japan's real estate woes could decimate the nation's banking industry, sending destruction ripples through the global economy."

This chart show comparative prices of commercial properties in eight major cities.



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The heart-and-soul of the computer revolution has been Apple, Microsoft and Intel. Steven Leeb of *Personal Finance* has some very interesting things to say about the chip situation as follows: In the past, chip speed would literally double or triple with each new chip. Not so anymore. This year Intel will introduce its P-6 chip, the next step following its fast pentium. But the increase in speed may not be noticeable. To benefit from the combination of the P-6 with Microsoft's new Windows-95, the user will have to upgrade his computer and lay out a good deal of extra cash. Leeb states that the new combination will have more bells and whistles on it, but it will not be necessarily faster. Then he points out that the next generation of the combined Windows/Intel system is going to be the signal that the industry is leaving its revolutionary development

stage for its evolutionary state. He adds, "Unfortunately, this transformation is occurring when mania in tech stocks is at its greatest. In other words, the market seems to be anticipating more revolutionary breakthroughs, when evolutionary improvements are in the cards. And to us that means trouble in computer paradise." **Russell comment:** The shaky price of the computer stocks and many technology stocks suggests that the market is taking careful note of the above reasoning.

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Hey, remember that $12.5 billion that Clinton loaned to Mexico in order to bail out US banks? Well, it seems that Mexico won't be paying us back on time (if, indeed Mexico ever pays off). A payment of $1.3 billion falls due at the end of October, and US officials haven't said whether the $1.3 billion will be paid or ahem, extended. Payments have already been extended twice this year. **Russell comment:** Bet on extensions -- lots of them. Meanwhile, I'm watching the peso which is now selling at 6.73 to the dollar (over 7 to the dollar is my crisis level).

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The columnist, Thomas Sowell, is a rare African-American; he's a conservative who writes a column for *Forbes* and the *Conservative Chronicle.* Last week Sowell wrote, "The Republicans may already have lost the 1996 presidential election. Ross Perot's creation of a new third party will undoubtedly siphon off part of the protest vote that would otherwise go to the party opposing Clinton. Even if Mr. Perot does not do as well as the 19% vote he received in the 1992 presidential election, he may still hand Clinton his second election victory without a majority of the popular vote" . . . *Fortune* magazine in its latest issue documents (very convincingly) the thesis that the political party with the smoothest and best organized convention invariably wins the election. As things are going, it's clear that the Dems with a single candidate are well organized and rolling along while the Republicans with nine squabbling candidates are disorganized and close to chaos. **Russell comment:** I've been saying all along -- Clinton is good at only one thing -- running for office. And he's running hard now. At latest look, Clinton's popularity is rising, while Dole's popularity is sliding (assuming Dole is even the GOP candidate). Dole, Gramm, Forbes, Lugar, maybe Powell, who knows? I wouldn't bet against a second term for Bill. One big problem for Bill -- he's losing in the South. Even his own state of Arkansas is not a sure thing. And many doubt whether Clinton can win without the South.

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Swiss Banks: The Swiss banks used to take anyone's money and no questions asked. Now, however, if a bank suspects a prospect is dealing in tainted or criminal money, they can turn the prospective depositor down. Or, as one Swiss banker put it, "If you take dirty money, you're in trouble." Actually, the most important change has been the '94 law which allows Swiss banks to report suspicious customers. Prior to '94, banks were legally bound to maintain confidentiality, no matter what. However, Swiss accounts may still be numbered, and here's the amazing fact: the 494 Swiss banks manage an estimated $2 trillion in assets, roughly half of the world's privately managed assets.

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Trivia: When O. J. Simpson was arrested, some historians stated that O. J. was the most famous American to be accused of a killing since Vice President Aaron Burr shot and killed Alexander Hamilton in a duel which took place in 1804. Like Simpson, Burr got off free. In fact, Burr not only served no time for the killing, he was never even brought to trial.

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Follow the Money (From *Variety,* Oct. 9): "And now the inevitable: the cast of the O. J. follies wants an afterlife. Marcia Clark signed with the William Morris office. Johnnie Cochran is talking with several agencies and F. Lee Bailey's ego is such that he'll probably start his own talent agency. As for O. J. himself, ICM still represents him but insists it will not solicit deals to help him profit from 'this tragedy'. It's as though the stars of a Broadway flop failed to notice there's no audience left. Can't someone tell these people to clear the stage; most of us are sick and tired of them. The TV post-mortems last week made all this abundantly clear. Who wants to hear Bailey call Darden 'a poor loser'? Who cares if Robert Shapiro doesn't want to speak to the other lawyers again -- none of us wants to; nor do we want to read their damn books." **Russell comment:** We may not want to read any more books but 40 (forty) O. J. books are either on the market or on their way to market.

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Currencies: Europe continues to struggle with the target of a single currency. A total of 14 European nations are involved. According to the Maastricht Treaty nations eligible for the single currency must have budget deficits of no more than 3%, federal deficits of no more than 60% of GDP and an inflation rate no worse than the best rate of the EMU members (meaning Germany). So far, only Germany and tiny Luxembourg have qualified for the single currency, and Germany obviously wants to lead Europe on the currency situation.

Following strong words from the German Finance Minister about a possible "two-tier system," many investors have grown fearful and are moving into the "safe" Swiss franc. This has pushed the Swiss franc to its highest level against the German mark in 20 years. The Swiss is a very limited (in quantity) currency, as are Swiss bonds, and the rush into the franc has driven the Swissie up to 87 cents (in dollar terms). Swiss subscribers write to tell me, "You can't believe how expensive it is to live in Switzerland." I tell them, "These days, if you want safety, you have to pay for it. Stay put and enjoy it."

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Soros: What's George Soros up to now? The latest: he's negotiating for the purchase of a stake in Hainan Airlines Co., the first foreign investment in a Chinese state airline. Why would George do that? One good reason: Beijing has forecast that Chinese airlines will carry 50 million passengers this year, three times as many as in 1990.

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Surprise? James Paulson of Investors Management Group (Des Moines) notes that a trend that has contributed to every profit boom since World War II is missing today. He's referring to sales increases for corporations. Total corporate sales growth during the '90s has been the slowest of any decade since the Depression. Up to this point, says Paulson, corporations have increased profits by laying off workers and also by replacing high-paid employees with temps. But Paulson thinks the above are one-shot procedures that are now losing their potency. With many overseas economies in recession, with US consumers up to their necks in debt and sales weak here, Paulson wonders just where the sales growth will come from. Next question: if sales remain sluggish, what will happen to profits?

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Subscriber Sandy Westwood of Yakima, WA has for sale a complete set of the original "Dow Theory Comment" letters by the great Robert Rhea. These are rare and are, in my opinion, the best advisory letters ever written. If interested call her at home at (509)248-6144.

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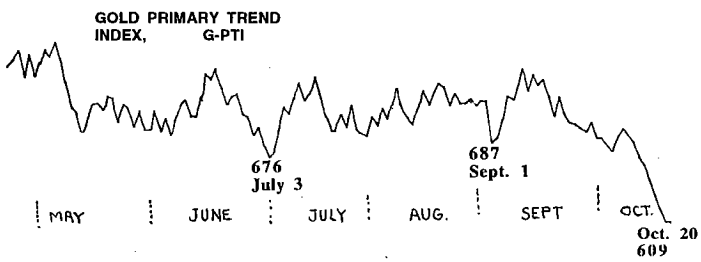
I grew up in the West 70s of NYC, just a few blocks from the famous Museum of Natural History. My father used to take me to the Museum on Sundays, and we were both fascinated with the great animal exhibits, and with the wonderful nature movies, many of them filmed by those early African explorers, Osa and Martin Johnson. The Johnsons' films were fairly primitive, but they did have the advantage of filming Africa during the '20s when it was relatively "unspoiled," and when it really was "darkest Africa." I still love wildlife films, many of which can be seen almost nightly on the marvelous Discovery Channel. The wildlife films of today are incredibly good, both in their filming technique and in what they show. Call me naive, but I think it's amazing to see thousands of wild beasts trying to cross a crocodile infested stream or to see a group of female lions stalking a group of zebras. Nature is savage and violent, but only man is so needlessly cruel to its own kind and on such a massive scale.

Speaking of nature, I've always believed that the more *efficient* a species, the better the chance of its survival. In animals, there's nothing more efficient than the insects. Proof: there are 950,000 identified species of insects and scientists believe that there are over

8 million species yet to be discovered. Question -- do you know of a single species of insects out of the 950,000 that is endangered? Facts: there are 70,000 known species of fungi, 75,000 known species of spiders and mites, 70,000 known species of mollusks, 40,000 known species of protozoa, 15,000 known species of round worms. But there are only 4,000 species of mammals, of which 950 of these are bats. Bats? Yes, bats are clearly one of the most efficient, if not the most efficient of any mammal species. Of course, bats have one singular advantage -- they are the only mammals that can fly (and don't tell me about flying foxes or flying squirrels, they only glide).

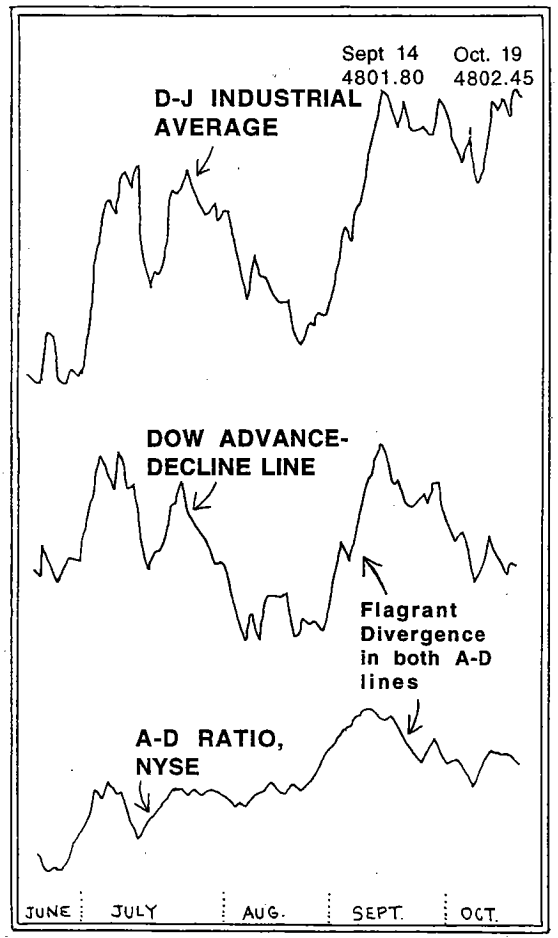
GOLD: You need a magnifying glass to find good news here. A few cycle-analysts tell us that gold is very near a cyclical low, and that this last decline should "clear the air." That's the hopeful side of it. But unfortunately, we must deal with an item called reality. The reality is that my Gold-Primary Trend Index has broken down, as you can see on the accompanying chart. Also, the Philadelphia Gold/Silver Index has rolled over and broken down. There should be some support on the XAU at 110 and major support at 100. On my point & figure chart support comes in for gold (the metal) at 376.

As for the gold shares, most of them are pretty much following the pattern of XAU. Why, why, why is gold weak? My reasoning -- almost every developed nation is now moving to down-size and to reduce their deficits. Rates-of-growth in money supplies are declining. Corporations are also down-sizing, continuing their policies of firing workers, computerizing, merging, closing branches (as per banking). The results are deflationary. And the deflationary trend is being reflected in gold's "blah" performance. Actually, in the face of these deflationary trends, gold has been holding remarkably well.



LATE NOTES: The page 6 chart reveals the flagrant **divergence** which now exists between the Dow and the Dow advance-decline line and the A-D ratio (the last is a proxy for all the stocks on the NYSE). I thought the action on Oct. 19 was particularly interesting. That was the day when the Dow closed at a new high of **4802.45.** But on the same day four more Dow stocks *declined* than advanced. Market breadth on that day (with the Dow up 24.93 points) was 1102 shares up and 1193 shares down.

So the big technical problem facing this market is whether breadth (in both the Dow stocks and the general market) will be able to catch up to price (as measured by the price of the Dow). Continued divergence, the failure of the breadth indices to confirm the price -- will most definitely lead to trouble.



Fundamentals: As I see it (and I've been warning about this for a long time), the **big picture** is that Washington is moving to burst the US deficit/credit bubble. The Republicans (with the Dems "sort of" going along with this) want to balance the US federal budget within seven years. This is a noble idea, but it should have been done twenty or even 10 years ago. The implications of actually balancing the federal budget are mind-blowing, and I don't know whether anyone's thought it through.

For instance, Japan finally was forced to face the danger of their "bubble economy." The Japanese Ministry of Finance and the Bank of Japan moved to deflate their monster credit bubble. The result was that Japanese real estate collapsed and Japanese banks were faced with half a trillion dollars worth of "non-performing" debt. The Japanese economy went into the tank, their stock market lost 62% of its value, and today the Japanese are still struggling with the results of the massive credit deflation.

Now cut to this side of the Pacific. US "prosperity" has been financed to a large extent with federal budget deficits of $800 million to $1 billion a DAY. In order to balance the federal budget, these massive deficits must be eliminated. But if the budget deficits are eliminated, the nation will surely head into recession. On the other hand, if the deficits are allowed to continue, the dollar will collapse. In fact, as this is written, the dollar has turned extremely weak. And I wonder if the latest (current) dollar weakness isn't reflecting a world view that Washington hasn't got the courage to even begin to eliminate our chronic deficits. Old-timers remember the song with the words, "You've Got Me in Between the Devil and the Deep Blue Sea." That's roughly where our politicians and the nation are today.

FINAL NOTE: As this is written, the dollar is very, very weak. What I don't like about the situation is that nobody is taking the dollar's collapse seriously. As I've said many times before, the US public is extremely naive when it comes to currencies.

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